On the other hand, full recovery of federal expenditures for inland waterways would undoubtedly result in serious disruptions to the barge industry and shippers. Full cost recovery would increase shipping costs by approximately 3 mills per ton-mile, or one-third over current average costs of 9 mills per ton-mile. In an effort to mitigate these adverse effects, however, charges might be imposed to recover only half of federal expenditures. At this level, the cumulative savings over the 1983-1987 span would be approximately $1.9 billion, and ton-mile costs would increase by about 18 percent.

LEVY USER CHARGES FOR DEEP-DRAFT NAVIGATION EXPENSES
(B-300-d)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.5	0.5	0.6	0.6	0.7	2.9

The U.S. Army Corps of Engineers spends about $500 million a year to maintain and improve ports and channels that accommodate oceangoing vessels and Great Lakes shipping. Substantial savings to taxpayers could be achieved if charges were levied on deep-draft vessels or shippers. Full recovery of federal costs would result in savings of about $2.9 billion during the 1983-1987 period.

Several different taxing mechanisms are available to recover the costs of deep-draft navigation. Most other countries charge a fee each time a ship uses a particular harbor or channel. Another approach would be a fuel tax; such a tax could easily be avoided in international shipping, though. Costs could also be recovered through taxes based on the value, volume, or weight of the cargo. (The U.S. Customs Service already collects a small tonnage tax on international shipping.)

If all federal government costs for deep-draft navigation were recovered by user fees, shipping costs would increase by about 26 cents a ton, or less than 3 percent. Such a level would probably not harm the general economy or divert significant amounts of shipping traffic to other countries or transportation modes.

One argument in favor of this option is that the Congress has broadly applied the user-charge principle to other modes of transport, including highways, airports, and to some extent inland waterways. There is no economic or technological reason why this same rationale should not be applied to deep-draft ports and channels. Arguments against this proposal include the administrative difficulty of accurately calculating federal expenditures for deep-draft navigation, the potentially disruptive shifts in traffic between U.S. ports and channels if user charges differed among ports, and the possibility of some small reductions in coastal trade between U.S. ports and transoceanic shipping.

LIMIT HOME MORTGAGE INTEREST DEDUCTION TO $5,000 (B-370-a)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	1.8	5.5	7.3	7.4	8.8	30.8

Home mortgage interest payments have always been deductible under the federal income tax, thus providing a large and popular subsidy for homeownership. Limiting the deduction to $5,000 a year would add $30.8 billion to federal revenues in 1983-1987. Limiting it to $10,000 would add about $5.5 billion.

Opponents of a limitation hold that, because the deduction stimulates homeownership, it promotes better home maintenance and greater civic involvement. Moreover, the subsidy it provides has been widely incorporated into prices and investment decisions throughout the economy and could not be eliminated without causing significant short-term losses and economic dislocation.

Recent economic studies suggest, however, that the deduction may have important adverse consequences both for housing markets and for the economy as a whole. Aside from reducing federal revenues, it appears to have weakened the demand for rental housing, thereby encouraging a decline in new rental construction and the conversion of existing rental units to condominiums and cooperatives. In addition, the deduction has promoted the rapid rise of home prices and encouraged the flow of individual savings into housing rather than into productive capital.

Many homeowners receive little or no benefit from the deduction. As recently as 1978, more than 60 percent of all homeowners either had no mortgage or used the standard deduction and thus gained no direct benefit from the mortgage interest deduction. Of those with mortgages, only 62.5 percent claimed the deduction.

If the Congress wished to reduce the revenue loss from the deduction, the simplest option would be to limit the amount of mortgage interest that could be deducted. If the ceiling was set high enough, most homeowners would not be affected. At the same time, price increases for more expensive homes would tend to moderate and the incentives for condominium conversion would decrease. For example, a ceiling of $5,000 effective January 1, 1983, would produce savings of about $1.8 billion in fiscal year 1983 and $5.5 billion in 1984. At 1981 income levels, this ceiling would affect about 5.7 percent of all taxpayers and 19.6 percent of those now taking the deduction, although the percentage of first-time homebuyers and recent purchasers would be considerably greater. Homeowners with a 12 percent mortgage would be affected only if their mortgage principal was over $41,650.

A $10,000 ceiling on the mortgage interest deduction would save $300 million in fiscal year 1983 and $1.0 billion in 1984, but it would also affect many fewer persons--0.6 percent of all taxpayers and 2.2 percent of those now taking the deduction. Homeowners with a 12 percent mortgage would only be affected if the principal was more than $83,500. At lower interest rates, mortgages with higher principals would be shielded from a tax increase; at higher rates, lower principals would be shielded.

Applying such limits only to new homeowners or newly purchased homes would lessen the immediate effects of any change. This could lead to a variety of perceived inequities, however. Most important, it would exempt from the ceiling those who have benefited most over the years from the tax treatment of homeownership and fixed-interest-rate mortgages, while imposing a tax on new purchasers for whom the financial advantages of homeownership have already been eroded by mortgages with high and variable interest rates.

Another way of limiting the immediate effect of a ceiling on deductions would be to set the ceiling even higher than $10,000, or to postpone its actual effective date until some time in the future. Either approach would allow people time to make reasonable adjustments in their homebuying and financial plans.

TAX 10 PERCENT OF THE CAPITAL GAINS ON HOME SALES
(B-370-b)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	a/	0.3	0.3	0.4	0.4	1.4

a. Less than $50 million.

Capital gains on home sales are not taxed so long as a new home costing at least as much is purchased within two years of the sale of the former. In addition, the first $125,000 of capital gains on a home sold by a person age 55 or over is not taxed at all. Replacing these provisions with a tax on 10 percent of long-term capital gains could add about $1.4 billion to federal revenues in the 1983-1987 period.

The provisions were intended to prevent hardships for owners selling their homes. Deferring the capital gains tax avoids putting an additional burden on owners who have to sell because of an increase in family size or an employment change. The $125,000 exclusion for those over 55 obviates a large tax after a lifetime of home price increases, much of it attributable to inflation.

In recent years, homeownership has come increasingly to be viewed as an excellent financial investment, competing with other forms of investment for financial resources. To the extent that the tax system favors capital gains from homeownership over capital gains from stock and other forms of business investment, savings are diverted from productivity-enhancing capital investments into housing.

Replacing the present deferral and $125,000 exclusion provisions with a small tax on long-term capital gains on housing would make the treatment of housing more like that of other assets. Ten percent of the gain on all home sales could be included in taxable income, for example, compared with the 40 percent that now applies to other long-term capital gains. This lesser percentage would take account of the fact that only a portion of the gain on housing represents true investment gain, since homes are still purchased primarily as places to live. If 10 percent of the gain were taxed, the tax on the total gain would never exceed 5 percent, and would be less for taxpayers with marginal rates below the top 50 percent rate. This option would simplify both tax administration and taxpayer compliance by reducing the need for homeowners to keep track of gains and expenses on a lifetime of principal residences.

If the option applied to all accrued capital gains rather than just those occurring after the date of enactment, it would have some of its largest effects on those who owned homes at the start of the 1970s, and who benefited from the fixed-interest mortgages and rapidly increasing home prices that made homeownership such a good investment during the past decade. If only gains occurring after the date of enactment were taxed, the option would affect mainly new home purchasers who face an environment in which mortgages with high and variable interest rates have made homeownership a less desirable financial investment. Applying the tax just to gains occurring after the date of enactment would be administratively difficult, however, since there is no convenient, noncontroversial method of allocating the accumulated gain between pre- and post-enactment periods of ownership. The estimated revenue increase given above assumes that 10 percent of all accrued gains are taxed at the time of sale.

TERMINATE DEDUCTIBILITY OF CONSUMER INTEREST PAYMENTS (B-370-c)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	1.2	7.8	8.1	8.5	9.6	35.2

Current law allows taxpayers to deduct all interest expenses on consumer and other non-business loans. The deduction is primarily used by middle- and upper-income households; 65 percent of the tax savings go to the 18 percent of taxpayers with $30,000 to $100,000 of adjusted gross income. Terminating the deductibility of interest other than that on mortgage, business, and investment loans would increase federal income tax revenues by about $35.2 billion in the 1983-1987 period.

Opponents of the deduction argue that it encourages buying on credit and discourages saving and thrift, particularly in times of inflation. In recent years, it has been cheaper to buy by borrowing at a high but tax-deductible interest rate than to save at a high but taxable interest rate and pay cash at an inflated price later.

Defenders of the deduction point out that limiting the deductibility of consumer interest would present significant practical and administrative problems. For example, if interest on mortgage loans continued to be deductible, taxpayers could take second mortgages on their homes and use the proceeds for consumption. Moreover, the change would have different impacts on different sectors of the economy. Financial institutions lending to consumers would probably lose some business, as would producers of credit-dependent products such as autos and major appliances. Permitting exceptions such as interest on auto loans could lessen the economic impact, but it would also increase the administrative difficulties and limit the revenue gain.

Permitting deductibility of interest on auto loans plus up to $1,000 of other interest would soften the impact on the affected sectors, but reduce the revenue gain to $0.2 billion in 1983 and $1.7 billion in 1987.

ELIMINATE TAX EXEMPTION FOR SMALL ISSUE INDUSTRIAL REVENUE BONDS (B-370-d)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.1	0.7	1.2	1.8	2.5	6.3

Tax-exempt small issue industrial revenue bonds (IRBs) are issued by state and local government agencies, but their practical effect is to subsidize private businesses by enabling them to borrow for plant and equipment at low municipal bond interest rates. IRBs were used infrequently before the 1960s, when a growth in sales to $1.8 billion led the Congress in 1968 to limit their use to purposes specified in the law, such as pollution control, or to "small issues" ($10 million or less) regardless of purpose.

Small issues are used to finance a wide variety of enterprises, from manufacturing plants to tennis courts. In 1980 alone, they amounted to more than $8.4 billion (up from $7.1 billion in 1979), accounting for about 15 percent of all 1980 long-term tax-exempt bond issues. Preliminary indications are that the volume of IRB issues in 1981 may have been as much as 40 percent greater than in 1980. The continued growth of IRBs is adding to pressures on municipal bond rates, which in recent months have not only climbed to historic highs, but have also risen more rapidly than conventional interest rates. As a result, the savings generally realized from tax exemption have diminished and the relative costs to municipalities of financing public works have risen. Eliminating the tax exemption would add about $6.3 billion to federal revenues in the 1983-1987 period.

The volume of small issue IRBs, with a fiscal year 1982 revenue loss approaching $1.6 billion, raises the question of under what circumstances the federal government should subsidize the borrowing costs of private industry. Unlike federal programs to assist private business directly, IRBs are not as a rule limited to specific geographic areas in need of economic development assistance nor to specific businesses that have difficulty obtaining conventional credit.

The advocates of continued tax exemption for small issue IRBs maintain that the bonds stimulate investment and promote job development. Opponents argue that, since not all projects are eligible for IRB financing, the primary effect of the interest subsidy is on the allocation of investment dollars rather than on the total amount of investment, which is much more likely to increase in response to general business tax cuts.

LIMIT BUSINESS MEAL AND ENTERTAINMENT DEDUCTIONS
TO 80 PERCENT OF AMOUNT SPENT
(B-370-e)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.3	0.6	0.6	0.7	0.7	2.9

Firms are allowed to deduct the full amount spent on business meals and other forms of entertainment as an "ordinary and necessary" business expense if the meal or entertainment is directly related to or associated with the firm's business. Limiting business meal and entertainment expense deductions to 80 percent of the amount spent would increase revenues by an estimated $2.9 billion in the 1983-1987 period.

This deduction has been the subject of continuing controversy, with opponents arguing that it provides a government subsidy for personal pleasures that have only a remote business purpose, and defenders arguing that the conduct of business is greatly facilitated by such expenditures. The Kennedy Administration in 1961-1962, and the Carter Administration in 1978, both proposed major cutbacks in business meal and entertainment deductions, but opposition from hotel, restaurant, and resort industry organizations and their workers prevented significant changes.

For tax purposes, it is often difficult to draw a line between ordinary and necessary business expenses and nondeductible personal expenses. If the line were drawn at expenses that serve the personal pleasure, comfort, or convenience of business executives and employees, for example, many common expenses such as extra-large and expensively furnished offices, company automobiles and airplanes, and expensive midtown hotels for traveling executives might become nondeductible. Limiting deductible meal expenses to a specific dollar amount would not take into account the wide variation in restaurant meal costs, and would not in fact distinguish business from nonbusiness meals.

To avoid these line-drawing problems, but at the same time place some limits on the government subsidy for business meals and entertainment, deductions for these expenses could be limited to, say, 80 percent of the amount spent. In the case of corporations, which have a top marginal tax rate of 46 percent, the government would then in effect pay 36.8 percent of the cost (46 percent times 80 percent) rather than 46 percent as now. Because businesses would have to pay a larger share of the cost of meal and entertainment expenses, they would likely impose somewhat tighter internal controls on these expenses. Firms themselves would have to consider more carefully whether the expense in question was closely enough related to an important business purpose to justify it.

INCREASE AVIATION USER FEES
(B-400-a)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.7	1.1	1.2	1.2	1.2	5.4

The federal government spent about $3.3 billion in 1981 for capital and operating expenses of the nation's air traffic system. General aviation (mainly, planes owned by firms and individuals for their own business and personal use) accounted for an estimated $890 million of the costs, but paid only about $35 million in the form of user charges, primarily through a 4 cents per gallon tax on aviation gasoline. Commercial airline travelers, through ticket taxes and other fees, have generally paid most of the costs attributed to them. In 1981, however, after the ticket tax fell from 8 percent to 5 percent, commercial airline users paid only 65 percent of the costs attributable to them.

Over the years, general aviation has paid only a small proportion of its associated costs. Even when the taxes on general aviation were at their height in 1978, general aviation paid for less than 15 percent of the costs attributable to it. Recovering all of the costs of general aviation would require that the taxes paid by private plane owners increase from 4 cents to about 80 cents per gallon of gasoline and jet fuel. Such an increase would raise the costs of flying private planes by less than 20 percent. Similarly, commercial aviation users would pay their total costs if the ticket tax was raised from 5 percent to about 6 percent. Together, these increases would raise revenues by about $5.4 billion in the 1983-1987 period. Taxpayers would continue to pay the one-sixth of air traffic system expenditures that represent costs not attributable to any one class of air traveler.

Proponents of this proposal argue that having users of the airway system pay their own way would encourage more efficient use of airports and airways, and would be more equitable as well. Opponents argue that greatly increased taxes might disrupt the general aviation industry, though the transition could be eased by using the approximately $3 billion surplus in the Airport and Airways Trust Fund to introduce increased charges gradually.

LEVY USER CHARGES FOR CERTAIN COAST GUARD ACTIVITIES
(B-400-b)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.7	0.9	1.0	1.0	1.1	4.7

The U.S. Coast Guard spends more than $1.1 billion a year on search-and-rescue activities, aids to navigation, marine safety, and environmental protection. Of this sum, more than 80 percent is allocated to different types of vessels and could be recovered through user charges.

For example, without navigational aids--such as buoys and other channel markings--commercial shipping in U.S. inland and coastal waters would be substantially more hazardous, difficult, and costly. The capital and operating costs of these aids could be recovered from the shipping industry, however, just as highway users (including both private and commercial users) pay for the costs of roads. The potential five-year savings from such user charges would total about $2.3 billion, or less than 2 percent of the transportation costs of all waterborne cargo.

The Coast Guard also engages in search-and-rescue operations for private mariners who are lost or otherwise in trouble; about one-half of such missions involve recreational boaters. These search-and-rescue costs (and other Coast Guard costs attributable to recreational boaters) could be recovered through registration fees on the 1.4 million large recreational boats berthed in coastal areas. Fewer than 20 percent of these boats would be charged more than $120 a year. Smaller fees of up to $10 a boat could be assessed on the more than 10 million recreational boats in inland waters. Other fees could be assessed on commercial and fishing vessels.

The argument for charging the shipping industry for navigational aids is that efficiency is enhanced when users of various modes of transportation pay the full costs of each mode. The argument for charging recreational boaters is simply that the beneficiaries of this special service (many of whom have higher-than-average incomes) ought to bear the costs. An analogy can be drawn to property owners, who pay through their property taxes for fire services even though they rarely need such services.

An argument against imposing such user charges is the difficulty of establishing fair cost allocations among the various kinds of users. Administrative problems could also arise in collecting a new set of fees from such numerous users. The charges might also cause some slight reduction in domestic shipping and recreational boating. Given the small increase in costs implied by these fees, most effects would be minor.

ELIMINATE TAX CREDITS FOR REHABILITATING OLDER BUILDINGS (B-450-a)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.8	1.1	1.3	1.5	1.7	6.4

The Congress in 1981 enacted large tax credits for amounts spent rehabilitating older income-producing buildings. The credits range from 15 to 25 percent, depending on the age of the building and whether it is historic. They were enacted as a subsidy to encourage businesses to renovate their existing premises rather than to relocate; to encourage people to purchase and put to new use older buildings that have outlived their original usefulness; and to encourage the preservation of historic buildings.

Eliminating the tax credits altogether would save $6.4 billion over the 1983-1987 period. Alternatively, cutting the size of the credits back to 10 percent for rehabilitations of buildings over 30 years old and 15 percent for rehabilitations of historic buildings would save $300 million in 1983, growing to $750 million in 1987, for five-year savings of $2.8 billion.

The following example illustrates how the 25 percent tax credit for rehabilitations of historic buildings works. A taxpayer who buys a dilapidated historic building for $200,000 and, using borrowed funds, spends $800,000 on renovation is entitled in the first year to a tax credit of $200,000 ($800,000 x 0.25). This reduces the owner's investment cost to zero, and in the typical case the owner realizes additional first-year tax savings of about $32,000 from depreciation allowances.

Because the current tax credits are so large, they seem certain to achieve their objective and to promote a great deal of renovation. At the same time, however, their size also ensures that many owners will receive large tax savings for doing what they would have done even if the credits did not exist or were not so large. Moreover, since the credits are not generally available for rehabilitation of housing (with the exception of housing in historic buildings), they will promote the conversion of some housing to commercial use and generally draw investment funds away from rental housing. They will similarly draw funds away from some new construction that could have contributed more to the efficient operation of the economy than the renovation that takes its place.

Because eligibility for the 25 percent credit requires both state and federal approval of a project, the credit could impose heavy demands on government resources. Between 700,000 and 1 million buildings now could qualify for the credit (subject to approval of the Department of the Interior), although only about 30 percent of them are currently income producing. From 1977, when tax incentives for historic preservation first became available, a total of only 3,500 project applications has been received by the Interior Department, but a big increase in applications is expected because the tax incentives were made so much more lucrative in 1981. The Interior Department expects to receive about 2,000 applications in 1982, with each project costing $500,000 on average.

In the face of general budget cutbacks, and in light of the sizable financial benefits that the project owners stand to receive, it might be desirable, if the credits are continued, to charge applicants a fee sufficient to cover the costs of the federal certification process. These user fees make sense particularly if the alternative is a certification process so overburdened that backlogs and lengthy delays become commonplace, dampening interest in the credits, or that the federal and state reviews become mere formalities.

If the Interior Department charged $300 per application, the $600,000 so raised in 1983 would roughly defray the federal cost of processing the applications. These offsetting receipts would reduce outlays in the Interior Department budget by that amount. The states and the Internal Revenue Service would still be left with sizable costs in administering the credits, however. If applications continued to increase, as they probably will, the application fees would save the federal government substantially more in future years.

REPEAL EXTRA PARENTAL PERSONAL EXEMPTION FOR STUDENTS
(B-500-a)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.3	0.9	0.8	0.8	0.8	3.6

Until a child turns 19, the parents can claim an exemption of \$1,000 if they contribute at least half of the child's support. Beyond that age, an additional test is imposed--the child must have less than \$1,000 income in order to qualify as a dependent. If the child is a student, however, the parents can claim an exemption regardless of the student's income, so long as they provide half of the support.

If the special exemption for students was repealed effective January 1, 1983, the increased federal revenues over the 1983-1987 period would total about \$3.6 billion.

The rule allowing a parental personal exemption for students, even if they earn more than the amount of the exemption, was adopted in 1954. The main reason for the rule was to avoid the "notch" problem that resulted when a dependent's earnings were close to the exemption amount; an extra few dollars in earnings could deprive the parents of the exemption, costing them hundreds of dollars in extra taxes. The exemption was also justified as a way of taking into account the added costs parents incur for students.

The main argument for retaining the exemption arises from the notch problem that prompted the 1954 change. Even though parents who support nonstudents aged 19 and over also face this problem under present law, most such nonstudents earn well over \$1,000 a year so that the question normally does not arise. Students, who often work only part time, are much more likely to have earnings for the year that come close to the \$1,000 dividing line.

TAX SCHOLARSHIP AND FELLOWSHIP INCOME
(B-500-b)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.1	0.3	0.3	0.3	0.4	1.4

Under current law, individuals are generally not taxed on scholarship and fellowship income unless the income is in return for services such as teaching or research not required of all candidates for a particular degree. Like prizes and awards generally, scholarships and fellowships are difficult to classify categorically as gifts or income. Gifts are not subject to income tax on the part of the recipient, but are subject to gift tax on the part of the donor. Until 1954, scholarships and fellowships were considered income unless the recipients could prove that they were expected to provide only nominal services in return, in which case the scholarships and fellowships were considered gifts and not subject to income tax. In 1954, formal rules elaborating on this principle were enacted by the Congress, the presumption now being that scholarship and fellowship income is generally not taxable. Ending the exclusion would add about $1.4 billion to revenues in years 1983-1987.

Even though most scholarships and fellowships are considered gifts and in theory are subject to gift tax on the part of the donor, in practice virtually no gift tax is collected on these transfers. The Economic Recovery Tax Act of 1981 increased from $3,000 to $10,000 the amount that can be given to each recipient free of gift tax each year and created an unlimited exclusion from gift tax of amounts paid for tuition expenses. Moreover, most scholarships and fellowships provided to individuals unrelated to the donor qualify for the income tax deduction for charitable contributions.

The argument for taxing scholarship and fellowship income is that it constitutes an increase in the power to consume in the same way that wage and salary income does. Not to tax scholarship and fellowship income is to discriminate against those who do not attend college or graduate school, or who work their way through school rather than getting financial aid, and in favor of academics, college athletes, and other scholarship and fellowship recipients. Because the first $3,300 of an individual's income is excluded from tax ($1,000 personal exemption plus the $2,300 zero bracket amount for single taxpayers), most students would owe little or no tax even if scholarship income was fully taxed. Those professors or students whose fellowships in reality represented salaries for full-time or nearly full-time employment would, however, have incomes greater than $3,300 and would owe tax.

The primary argument in favor of the exclusion is that scholarships and fellowships are more like gifts than income. In addition, the exclusion is one way of subsidizing higher education, long a policy of the federal government. Moreover, students supported by their parents are not taxed on the amounts they receive from them for college expenses.

If taxing all scholarship and fellowship income was considered too drastic a departure from current practice, the exclusion of this income could be continued but only for undergraduate students, or with an annual limit imposed on the exclusion. Nondegree candidates are now allowed to exclude from taxable income only $300 per month of scholarship and fellowship income, and this rule could be extended to degree candidates.

TAX FRINGE BENEFITS
(B-500-c)

	Annual Added Revenues (billions of dollars) 1983	1984	1985	1986	1987	Cumulative Five-Year Addition
Addition to CBO Baseline	0.5	1.1	1.2	1.4	1.6	5.8

The Congress has for several years prohibited the Internal Revenue Service from publishing regulations for the taxation of "fringe benefits," which are certain forms of nonwage employee compensation. Although fringe benefits are legally subject to tax, they cannot be taxed on a consistent basis without comprehensive regulations, and so in practice they have been excluded from taxation. Examples of such benefits are the private use of a company car, discounts on employers' products, reduced-price meals, subsidized day care, reimbursement for recreational expenditures while on business travel, tickets to sporting or cultural events, and club dues. (Some other fringe benefits, such as employer contributions for life and health insurance premiums, are specifically excluded from taxation in the law and thus do not fall into this category.)

If the Congress would permit regulations governing the taxation of these fringe benefits to be issued, the revenue gain over 1983-1987 could approach $6 billion.

At present, a taxpayer with no employer-provided fringe benefits pays the same tax as another with an equal salary and generous fringe benefits. Employees have a strong incentive to bargain for more of their compensation in the form of untaxed fringe benefits. This shrinks the overall tax base, increases the tax rates necessary for all taxpayers, and--in a continuing cycle--further increases the incentive to bargain for untaxed fringe benefits. The exemption from tax further misallocates resources by inducing employees to bargain for fringe benefits that they would not buy themselves. Thus an employee in the 30 percent tax bracket is encouraged by the tax exemption to seek fringe benefits costing the employer $1 that the employee would not buy for more than 70 cents.